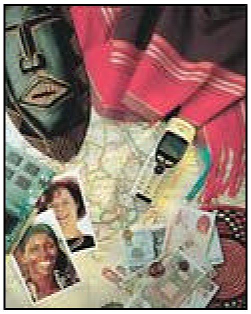

FINANCE & DEVELOPMENT
A quarterly magazine of the IMF
December 2001, Volume 38, Number 4

The New International Financial Architecture and Africa

Saleh M. Nsouli and Françoise Le Gall

Search F&D
Search
Advanced Search

About F&D
Subscribe
Back Issues
Write Us
Copyright Information

E-Mail Notification
Subscribe or Modify your subscription

At first glance, the new international financial architecture would seem to have little relevance for Africa—it was built up in response to developments that took place far from Africa and whose direct impact on Africa was limited. Nonetheless, key components of the international financial architecture are very relevant for Africa.

The crises that shook Mexico in 1994-95 and East Asia in 1997-98 came as a stark reminder that economic fundamentals—sound national macroeconomic and structural policies and a sound and properly regulated financial system—were as critical as ever. The crises also highlighted the new tensions that had arisen in the international financial system amid the rapid growth and integration of capital markets and alerted policymakers to the need for new practices to strengthen the system. The crises that erupted in Russia in 1998, Brazil in 1998-99, and Turkey and Argentina in 2001 have only emphasized the importance of rethinking the international financial architecture to ensure a smoothly functioning and orderly international financial system, maximize the benefits of globalization for all countries, and prevent financial crises or manage them effectively if they do occur.

Reform of the international financial architecture is being undertaken on several fronts. The main elements are

- promotion of transparency, accountability, and good governance, which, by fostering broad discussion of economic policies and improving the provision of information to markets, can help countries bolster their

economic performance;
- adoption of international standards and codes, which provide benchmarks against which to assess the performance of individual countries;
- strengthening of financial systems, which contributes significantly to domestic and international financial intermediation, helping to mobilize savings and channel them efficiently to productive investments;
- orderly capital account liberalization through careful management and sequencing so that countries are able to benefit from open capital transactions while minimizing the risks of sudden capital movements;
- implementation of sustainable exchange regimes, which are critical to macroeconomic stability and competitiveness;
- development of modalities for the involvement of the private sector in forestalling and resolving crises; and
- reform of the IMF's nonconcessional lending facilities to focus more on crisis prevention and to ensure more effective use of IMF resources.

These initiatives for a new international financial architecture are complemented by initiatives focusing on debt relief and poverty reduction for low-income countries. To the extent that the international financial architecture is a force for macroeconomic stability, it also contributes to growth, which is crucial to efforts to fight poverty. To address the problems of poverty and high debt levels more effectively, in 1996 the IMF launched the Heavily Indebted Poor Countries (HIPC) Initiative jointly with the World Bank, and, in 1999, replaced the Enhanced Structural Adjustment Facility with the new Poverty Reduction and Growth Facility (PRGF), which, like its predecessor, provides concessional loans.

Relevance to Africa

The relevance of the international financial architecture to Africa becomes apparent when we look at Africa's policy agenda, particularly the following three elements:

Consolidation of macroeconomic stability. During the past five years, sub-Saharan Africa has achieved greater macroeconomic stability and seen a significant pickup in its overall growth rate. Experience worldwide indicates that macroeconomic stability is necessary for economic growth and that growth can raise incomes and reduce the incidence of poverty. But Africa's economic stability remains precarious, and economic growth is far below what is needed to make a lasting dent in poverty.

Increase in investment. In sub-Saharan Africa, gross domestic investment, at about 17 percent of GDP, falls far short of investment in other parts of the world. In addition, sub-Saharan Africa accounts for a very small share of the large amounts of foreign direct investment in the world economy—the kind of investment that could bring Africa not only the capital but also the technology and know-how it needs. Most African countries have some way to go to establish a secure economic environment, without which both domestic and foreign investors will continue to shy away from opportunities in the region.

Strengthening of financial sector. Given the still-fragile state of their financial sectors, African countries need to take measures that will enable financial markets to mobilize savings and allocate credit more efficiently and that will make financial products and services available to more of their citizens.

Africa can make progress toward achieving these objectives by applying the principles underlying the new international financial architecture. By increasing transparency and accountability and bringing their financial sectors up to international standards and codes, African countries can improve decision making and develop sounder national economic policies while creating an environment that encourages investment and saving. More generally, by putting broad interests ahead of specific—or vested—interests, national authorities will be able to address poor governance in its various forms—corruption, inefficient management of public resources, lack of accountability of government officials, and unresponsiveness to the public's expectations and needs. There is increasing evidence that poor governance, notably corruption, dampens investment and growth. In sum, tackling governance problems in Africa will, in turn, help sustain economic development. Measures that promote orderly capital account liberalization and an understanding of exchange rate regimes will help bring the benefits of international capital flows to African countries. And, by promoting a stable global financial system, the new financial architecture will serve Africa's interests. Finally, efforts to strengthen financial systems, push through rapid and comprehensive debt relief, and reduce poverty will benefit both Africa and the international community.

What is being done in Africa?

African countries and the IMF have launched a number of initiatives to promote the new international financial architecture in Africa. This article focuses on transparency and accountability, international standards and codes, and financial systems because of their greater relevance to Africa at this stage.

Overall, transposing the international financial architecture to Africa will not be easy, particularly for some countries, as the following examples demonstrate.

- It is sometimes difficult to separate governance issues from weaknesses in institutional and administrative capacity. Poor governance may not always reflect a lack of government commitment. Even with strong and honest political leadership, eliminating corruption in Africa will take time.
- The plethora of international standards and codes can be overwhelming and highly demanding of human and financial resources, and meeting them may overstretch the capacities of African countries.
- A number of standards and codes were originally formulated for industrial countries and may not fully take into account conditions in Africa. For example, it may be easier for banks in industrial countries to meet international standards for portfolio concentration and exposure to a single client than for banks in Africa's developing countries, where there is little economic diversification and the economic scene is dominated by a few large enterprises.
- Constraints on the functioning of markets can reduce the effectiveness of market discipline and, hence, of transparency in African countries. For instance, there tends to be more state ownership of enterprises and banks in Africa than in industrial countries and, partly for this reason, the extent to which the market can be relied upon to impose discipline is limited.

Issues such as these, however, do not constitute arguments for Africa to reject the international financial architecture. Rather, they underscore the need for fundamental reforms to close loopholes and eliminate administrative procedures that facilitate corruption, strengthen institutional capacity, and reduce government intervention and allow markets to operate efficiently. To be able to apply the standards and practices prevailing in industrial countries, the African countries will need considerable technical assistance.

Transparency and accountability. African governments have initiated important fiscal and public sector reforms to enhance transparency and accountability, generally in accordance with the IMF's Code of Good Practices on Fiscal Transparency. In a number of countries, budgetary laws and public accounting regulations are being modernized; various funds and accounts are being consolidated; budget execution is being streamlined and computerized; procurement procedures are being tightened; and control functions are being strengthened. In an effort to root out corruption, some countries have established national governance strategies or agencies.

African countries are also participating in initiatives to improve transparency in the IMF's own policies and operations. A good many of them have authorized publication by the IMF of Public Information Notices (PINs) and documents related to national programs supported by the IMF. Several have allowed publication of IMF staff reports on their Article IV consultations (in accordance with Article IV of the IMF's charter, IMF staff members meet regularly—usually annually—with government officials of individual member countries to gather economic information, review exchange rate policies, and share international experience), as well as on their use of funds borrowed from the IMF.

International standards and codes. Reports on the Observance of Standards and Codes (ROSCs), introduced by the IMF in 1999, aim to provide summary assessments—in cooperation with national authorities and other international bodies—of members' progress in implementing internationally recognized standards and codes and to provide recommendations on how implementation could be further improved. These reports consist of up to eight modules covering different areas: data dissemination, fiscal transparency, monetary and financial policy transparency (covered by the IMF's Code of Good Practices on Transparency in Monetary and Financial Policies), banking supervision, securities market regulation, insurance supervision, payment systems, and corporate governance. ROSC modules have been prepared for Cameroon, Mozambique, South Africa, Uganda, and Zimbabwe, as well as for Algeria and Tunisia.

In the area of data standards, the authorities in several

African countries are taking steps to enhance the quality and timeliness of their statistics. Their efforts focus on reinforcing the legal basis for statistical work, updating statistical series and upgrading them to recognized standards (for example, those set by the IMF's *Balance of Payments Manual* and *Government Finance Statistics*), and improving data on poverty and social sector issues. At this stage, South Africa and Tunisia have subscribed to the Special Data Dissemination Standard (SDDS); Benin, Cameroon, Côte d'Ivoire, The Gambia, Mali, Mauritius, Senegal, Tanzania, and Uganda are participating in the General Data Dissemination System (GDDS); and another 20 countries in Africa have expressed their intention to participate in the GDDS.

Strengthening of financial systems. In the wake of severe banking distress during the 1980s and 1990s, a number of countries in Africa launched medium-term programs to restructure weak banks (including measures to address the stock of nonperforming loans and accumulated losses of distressed banks). Furthermore, the authorities have increasingly focused on improving bank regulation and supervision, essentially through greater compliance with the Basel Committee's Core Principles for Effective Banking Supervision.

The Financial Sector Assessment Program (FSAP), initiated by the IMF and the World Bank in 1999, plays a major role in efforts to strengthen financial systems worldwide and provides a comprehensive framework for identifying strengths and weaknesses in a country's financial system. Cameroon and South Africa were part of the initial one-year pilot begun in 1999. With the extension of the program, Ghana, Senegal, and Tunisia are among the new group of countries for which FSAPs have been undertaken, and Gabon and Uganda have confirmed that they will participate in the program during the IMF's fiscal year 2002 (May 1, 2001-April 30, 2002) or later.

Debt, growth, and poverty reduction

In parallel with its efforts to advance the new international financial architecture, the IMF has sought specifically, through two channels, to confront the issues of debt and poverty.

First, the HIPC Initiative, which was launched in 1996, aims at reducing the external debt burden of eligible countries—most of which are in Africa—to sustainable levels. The initiative, which was enhanced in 1999, now also focuses on ensuring additional finance for social sector programs, primarily basic health care and education. A total of $34 billion of debt relief (in nominal terms) has been committed to 23 countries under the HIPC Initiative, and, of this, $25 billion has been committed to 19 African countries.

Second, the PRGF represents a commitment by the international community to integrate the objectives of poverty reduction and growth more fully into the operations of the IMF in its poorest member countries. Moreover, with a focus on good governance—better management of public resources and greater transparency, active public scrutiny, and generally increased government accountability in fiscal management—the PRGF provides an important link between poverty reduction and the international financial architecture. Financing and technical assistance made available under economic programs supported by the PRGF help countries implement components of the international financial architecture. Of the IMF's 77 low-income member countries eligible for PRGF assistance, 40 are in Africa. At the end of August 2001, there were 24 arrangements supported by the PRGF in Africa, with commitments totaling SDR 1.9 billion and disbursements, SDR 732 million.

All in all, African countries have made progress on various elements of the new architecture, but more work is needed—in particular, to enhance transparency and accountability, implement standards and codes, and strengthen financial systems. Progress made in these areas will help African countries to share more fully in the benefits of globalization and to achieve their twin goals of sustained growth and poverty reduction.

This article draws upon Françoise Le Gall and Saleh M. Nsouli, 2001, "The New International Financial Architecture and Africa," IMF Working Paper 01/130 (Washington: International Monetary Fund).

Saleh M. Nsouli is Deputy Director of the IMF Institute. **Françoise Le Gall** is Deputy Chief of the IMF Institute's African Division.